

REPORT OF EXAMINATION
OF THE
CALIFORNIA FAIR PLAN ASSOCIATION

AS OF
SEPTEMBER 30, 2005

Filed March 6, 2007

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION.....	1
MANAGEMENT AND CONTROL	2
TERRITORY AND PLAN OF OPERATION	4
REINSURANCE:	6
Assumed.....	6
Ceded	6
FINANCIAL STATEMENTS:.....	7
Statement of Financial Condition as of September 30, 2005	8
Statement of Income and Members' Equity for the Year Ended September 30, 2005.....	9
Reconciliation of Members' Equity from September 30, 2001 through September 30, 2005	10
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	11
Unpaid Losses and Unpaid Loss Adjustment Expenses	11
Members' Equity	11
SUMMARY OF COMMENTS AND RECOMMENDATIONS:.....	12
Current Report of Examination.....	12
Previous Report of Examination	12
ACKNOWLEDGEMENT	13

Los Angeles, California
November 30, 2006

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

CALIFORNIA FAIR PLAN ASSOCIATION

(hereinafter also referred to as the Association) at the primary location of its books and records, 3435 Wilshire Boulevard, Suite 1200, Los Angeles, California 90010.

SCOPE OF EXAMINATION

The previous examination of the Association was made as of September 30, 2001. This examination covers the period from October 1, 2001 through September 30, 2005. The examination included a review of the Association's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of September 30, 2005, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Association's operations were reviewed including the following areas that require no further comment: association history; corporate records; fidelity bonds and other insurance; officers' and employees' welfare and pension plans; growth of association; business in force by states; loss experience; accounts and records; and sales and advertising.

MANAGEMENT AND CONTROL

The Association is managed by a thirteen-member governing committee. Nine members are elected annually from member companies and are voting members. Four members are appointed by the Governor for indefinite terms and are non-voting members. The representation on the governing committee is specified in California Insurance Code Section 10094 and in the plan of operation. A listing of the governing committee members serving as of September 30, 2005, follows:

Voting

<u>Name</u>	<u>Company</u>	<u>Representing</u>
John Boyle Chairman	Automobile Club of Southern California	At-large insurance companies
Jack McGraw Vice Chairman	Pacific Specialty Insurance Company	At-large insurance companies
Brian Deephouse Secretary	Farmers Insurance Group	Other non-stock insurers
Fred Strauss	Allstate Insurance Company	National Association of Independent Insurers
Mark Eljenholm	SAFECO Insurance Companies	Other stock insurers
William Martin	The Hartford	American Insurance Association
Mark Simmonds	Liberty Mutual Group	The Alliance of American Insurers
Kevin Stockton	State Farm Insurance Companies	At-large insurance companies
Mitch Ziemer	Fireman's Fund Insurance Companies	At-large insurance companies

Nonvoting

<u>Name</u>	<u>Company</u>	<u>Representing</u>
Wes Bannister	Bannister & Associates Insurance	Insurance Brokers
Howard King	Modern Corporation	Public
Vacant*		Insurance Agents
Vacant*		Surplus Lines

*The Association has contacted the Governor regarding the vacancies and is waiting for the Governor's appointment of the two members.

George Yen, Chief, Rate Specialist Bureau, is the designated liaison of the California Department of Insurance.

The following schedule shows the management staff responsible for the daily operation of the Association as of September 30, 2005:

<u>Name</u>	<u>Title</u>
Stuart M. Wilkinson	President and General Manager
Victor R. Natividad	Vice President - Finance
Alfred Hess	Vice President - Claims
James Thomas	Vice President - Underwriting
Diane Wimsatt	Vice President - General Operations
Michael Harris	Vice President - Public Affairs
Cesar Flores	Vice President - Information Systems

TERRITORY AND PLAN OF OPERATION

The Association writes fire, extended coverage, vandalism and malicious mischief, and commercial sprinkler leakage on risks located in urban areas designated by the California Insurance Commissioner. It also writes in certain specified geographical areas or hazardous brush areas as designated by the Insurance Services Office. One-year policies are issued and premium rates are based upon the Association's (Fair Plan) experience.

The purpose of the Association is to provide coverage in areas where applicants have been unable to obtain coverage in regular markets. However, no active procedures are currently used by the Association to determine if any attempts have been made by applicants to place the risk in the regular market. It is assumed that producers would not attempt to place business in the Association if comparable coverage was available in the regular market.

The Association is not an insurer, but a mechanism to spread the risk, premiums, losses and expenses among participating insurers. The Association is a separate joint venture of all insurance companies (participants or participating insurers) holding certificates of authority from the California Department of Insurance for each class of business. The Association's plan of operations provides that the policies of insurance written and issued by them are on behalf of the participating insurers and that the respective liabilities of the insurers are several and not joint, and each such insurer is considered to be a direct insurer for its share in such writing.

All activity of the Association is on behalf of its participating insurers. For this reason, it does not have a certificate of authority as an insurance company. Likewise, it does not have a producer's license as it is composed of its participating insurance companies. Therefore, producers are not appointed agents of the Association and they cannot bind coverage. All producers licensed by the State of California are eligible to produce business for the Association.

The Association writes its own policies and collects premiums, pays return premiums and commissions and various general expenses. The Association contracts with and assigns independent adjusters to adjust claims filed against coverage provided by its policies and pays claims and related loss adjustment expenses. Unallocated general expenses are apportioned between claims and underwriting. Each participating insurer includes its portion of the Association's written premiums with its direct business and pays the associated premium tax.

Member insurers' participation percentages are reduced proportionately by the amount that they voluntarily write in the designated brush areas and certain urban areas.

The maximum limit of liability that may be placed through the Association is as follows:

Description of Coverage	Maximum Limit Amount
Dwelling Buildings and Contents	\$1.5 million per one location
Commercial Buildings	\$3 million
Commercial Building Contents	\$1.5 million maximum for each tenant
The maximum cumulative coverage for all tenants' contents, which can be insured in a single commercial building, is \$3 million, unless the following conditions are met:	
1. \$3 million and up to \$5 million contents coverage if the building is protected 24 hours by a guard service on the premises.	
2. \$5 million and up to \$10 million contents coverage if the building is protected 24 hours by a guard service on the premises and it has an automatic sprinkler system approved by the Insurance Services Office.	

A Business Owners' Policy (BOP) is available to certain commercial property owners and to small-to-medium-sized business operators. The BOP provides a package of coverages for eligible risks, which includes mandatory property and liability coverages, with burglary and robbery offered as optional coverage. BOP comprises approximately 6% of the total Association writings.

In December 1996, the California Earthquake Authority (CEA) was created by the California State Legislature to help resolve the insurance availability crisis in California following the 1994 Northridge earthquake. The Association participated in the CEA and made a \$15 million capital contribution. The participation was designed to limit the Association's earthquake exposure. As of September 30, 2005, the Association has a 1.44% share of the total CEA market and its maximum exposure to earthquake loss is approximately \$52.5 million. Future assessments in the event of a catastrophe are dependent upon the Association's CEA earthquake market share, the magnitude of the earthquake losses and the financial status of the CEA.

Effective May 30, 2001, the California Insurance Commissioner issued an order expanding the geographic areas eligible for coverage to provide relief to those who live in high risk areas with no insurance options and who were formerly ineligible for Association coverage. In order to obtain coverage, the applicants must provide confirmation that they have been rejected from three insurers.

REINSURANCE

Assumed

The Association did not assume reinsurance during the examination period.

Ceded

As of September 30, 2005, the Association's ceded reinsurance consisted of a catastrophe excess of loss reinsurance agreement with Lloyd's of London (the largest participant at 37.5%) and various other participants covering catastrophic brush fires losses in areas subject to brush and wild fires. The Association's retention is \$100 million and the reinsurer's maximum limit of liability is \$100 million in excess of the Association's retention. This agreement was first effective on February 1, 1999 and has been renewed annually. As of September 30, 2005, there have been no losses ceded under this reinsurance agreement.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of September 30, 2005

Statement of Income and Members' Equity for the Year Ended September 30, 2005

Reconciliation of Members' Equity
from September 30, 2001 through September 30, 2005

Statement of Financial Condition
as of September 30, 2005

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Investments	\$ 89,339,939	\$	\$ 89,339,939	
Cash and cash equivalents	14,272,909		14,272,909	
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	4,891,884		4,891,884	
Electronic data processing equipment	840,788	840,788		
Interest income due and accrued	632,087		632,087	
Equipment, furniture and supplies	<u>483,218</u>	<u>483,218</u>	<u></u>	
Total assets	<u>\$110,460,825</u>	<u>\$ 1,324,006</u>	<u>\$109,136,819</u>	
<u>Liabilities and Members' Equity</u>				
Unpaid losses			\$ 12,067,684	(1)
Unpaid loss adjustment expenses			1,529,473	(1)
Commissions payable			1,012,803	
Accrued expenses			328,067	
Unearned premiums			46,338,088	
Advance and unapplied premiums			3,417,930	
Other liabilities – post-retirement benefit accrual			<u>3,981,881</u>	
Total liabilities			68,675,926	
Total members' equity			<u>40,460,893</u>	(2)
Total liabilities, and members' equity			<u>\$109,136,819</u>	

Statement of Income and Members' Equity
for the Year Ended September 30, 2005
Statement of Income

Underwriting Income

Premiums earned		\$ 82,911,774
Deductions:		
Losses incurred	\$ 31,502,746	
Loss expenses incurred	3,831,570	
Other underwriting expenses incurred	<u>19,630,862</u>	
Total underwriting deductions		<u>54,965,178</u>
Net underwriting gain		27,946,596

Investment Income

Net investment income earned		<u>2,448,639</u>
Net income		<u>\$ 30,395,235</u>

Members' Equity

Members' equity, September 30, 2004		\$ 23,495,226
Net income	\$ 30,395,235	
Change in assets not admitted	63,057	
Interim assessment	6,584	
Distribution of equity	(13,578,538)	
Minimum pension liability adjustment	<u>79,329</u>	
Change in members' equity		<u>16,965,667</u>
Members' equity, September 30, 2005		<u>\$ 40,460,893</u>

Reconciliation of Members' Equity
from September 30, 2001 through September 30, 2005

Members' equity, September 30, 2001, per Examination			\$ 18,065,475
	<u>Gain in Equity</u>	<u>Loss in Equity</u>	
Net gain	\$ 82,560,009	\$	
Change in nonadmitted assets	859,190		
Assessments from member companies	9,692,990		
Distribution to member companies		69,574,802	
Aggregate write-ins for losses in surplus	<u> </u>	<u>1,141,969</u>	
Totals	<u>\$ 93,112,189</u>	<u>\$ 70,716,771</u>	
Net increase in members' equity for the examination period			<u>22,395,418</u>
Members' equity, September 30, 2005, per Examination			<u>\$ 40,460,893</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Unpaid Losses and Unpaid Loss Adjustment Expenses

The liabilities for unpaid losses and unpaid loss adjustment expenses include an amount determined from individual case estimates and loss reports and an amount, based on past experience, for losses incurred but not reported. Losses incurred are directly allocated to pool years based upon the effective date of the policy. Allocated loss adjustment expenses are allocated to pools directly, and unallocated loss adjustment expenses are allocated to pools by a ratio of claims paid.

Pursuant to California Insurance Code Section 10094, the Association is empowered to assess member companies their proportional share of losses incurred in a pool year. The Association's governing committee must approve all assessments. Assessments are allocated to pool years based upon the effective date of the policy covering the event deemed to have caused the pool year loss. A review of the four-year examination period disclosed that the Association assessed member companies a total of \$9,692,990.

The Association is not required to prepare an analysis of losses and loss expenses (Schedule P) or to provide an actuarial opinion.

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Association's unpaid losses and unpaid loss adjustment expenses as of September 30, 2005 were found to be reasonably stated and have been accepted for purposes of this examination.

(2) Members' Equity

The Association reviews pool years annually to determine if a distribution of members' equity is appropriate. Upon approval of the Governing Committee, the Association issues a preliminary distribution of members' equity. Subsequent yearly adjustments are made to the pool year until unpaid losses permit a final settlement of members' equity. Upon final settlement, the pool year is

closed. The Governing Committee is empowered to reduce the distributions by deficits incurred in other pool years. A review of the four-year examination period disclosed that the Association distributed a total of \$69,574,802 to member companies.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

Reinsurance - Ceded (Page 6): It was recommended that the Association amend its reinsurance agreement upon renewal to comply with California Insurance Code Section 922.2 and Statements of Statutory Accounting Principles No. 62. The Association complied with this recommendation.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Association's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

_____/S/
Martha Young
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California